

Texas Bond Buyer Conference, February 2012, Comments by Controller Green

Panel Topic: The State of the Marketplace

Mediator: Gavin Murphy (Source Media/Bond Buyer)

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How are concerns about credit affecting municipal issuers?

As you know the headlines in late 2010 and early 2011 predicting increased municipal defaults put a spotlight on municipal bonds. The increased scrutiny required the City of Houston to increase our efforts to promote the City's various credits. While Houston did not go unaffected by the national recession, the severity of the recession did not come close to what other parts of the country endured during the height of the crisis, given our stable housing market which did not experience the dramatic upswings and subsequent precipitous declines and thriving energy sector. Fortunately, Houston was on the LIFO method, only being pulled into the late wave of the recession, and rebounding fairly quickly.

So we sought out the various stakeholders, including the rating agencies, current and prospective investors, and media outlets. Rather than wait to engage the rating agencies when a specific deal was coming to market, we contacted them to schedule meetings to discuss our current financials and upcoming budget....including the bright spots and the challenges on the horizon. It was also important that we point out the steps we were taking to address these challenges. I am proud to note that we were able to maintain our ratings despite fiscal challenges, even successfully having the rating agency outlook improved on one of our credits. And, one of the factors that the agencies pointed out as a strength in the rating reports was the City's strong management.

Transparency is also vital. While the City has always been big on transparency, including making its monthly financial reports, quarterly investment reports and annual audited reports available on its website, the increased headline risk swirling around muni's made it all the more imperative. Instead of simply making these documents available online, we felt it was important to actively engage the stakeholders by providing some context. We reached out to some of the City's biggest bondholders and our liquidity providers.

When the time came to price a specific transaction[a \$273M Water System deal led by Rice Financial Products in February 2011], in addition to the measures I just outlined, we worked closely with our underwriter to ensure we were doing everything to facilitate a smooth transaction. This was even more important during this time with in such a precarious state having been spooked by the negative media reports. We made sure our offering document was available at least two weeks prior to the bond sale and also tied down the preliminary deal structure early to ensure that our lead manager would have a fair amount of time to market the deal. We also spoke with several industry media outlets, including Bond Buyer and Bloomberg in the week leading up to the sale. We also monitored secondary market activity on our outstanding bonds to identify any significant widening of spreads, which might indicate

that we should change the date we planned to price. All of these efforts paid off when we were able to generate strong investor demand and subsequently reprice at lower yields.

How is Houston Doing Specifically?

Again while there were no parts of this nation that did not feel the effects of the national recession, Houston was fortunate enough to fare better than many other cities. With property valuations remaining fairly constant, our new motto has quickly become “flat is the new up.” The limited growth in property tax revenue and sales revenue required us to make some tough choices during Fiscal Year 2011. These included furloughing employees to save money, lay-offs and not replacing workers as the City’s workforce decreased due to attrition. As a result of the measures taken in 2011, the number of employees in the City’s General Fund decreased by over 10% from 15,280 in FY 2011 to 13,648 in FY12. While it has become a cliché, the numbers attest to the fact that we really have had to do less with more. Property tax revenue appears to be stabilizing and we have experienced higher than projected growth in sales tax revenue over the past few months.

Fortunately, as I stated earlier Houston’s recession/recovery cycle could be characterized as being on the LIFO method.

- Houston was hit by the recession in 2008, with the region losing over 152,000 jobs through January 2010. Houston started to recover jobs in February 2010, and as of October 2011 the Houston region had gained 153,000 jobs or 101.1% of the jobs it lost. According to the Greater Houston Partnership, Houston will gain over 84,000 jobs over the next year. The Perryman Group predicts that Houston will lead the state’s population growth over the next 25 years, adding 3.37 million residents.
- In 2011, foreign trade grew at an unprecedented level; with imports growing by over 28% from \$154.4 million to \$198.4 million. Though I must note that a weakened dollar has played a part in the increased export amounts.
- The City of Houston ranks second in the number of fortune 500 companies, with New York City ranked first.
- Houston’s population growth has been exponential over the past 10 years...just by way of comparison national growth averaged 9.1 percent, population growth in Texas grew by 18.8 percent during the same time period, and growth in the Houston metropolitan area grew by 24.4 percent. We relish the fact that Houston is growing at such a rapid pace (#1 one way Uhaul destination), but are mindful of the challenges that come along with that growth.
- Moreover, the purchasing power of the Houston region grew by \$1 billion from the first quarter to the second quarter of 2011.

That does not mean that we are taking our eye off the ball, the City has established a long range planning task force to ensure our long-term fiscal sustainability while meeting the additional needs for services and expanded infrastructure that come with such rapid growth. The City has a \$1.5 billion Public Improvement capital plan over the next five years.

We continue to seek ways to reduce costs, including opportunities to refund debt. Over the past 14 months, the City took advantage of historic low rates and refunded over a billion in debt which will generate more than \$150 million in savings over the next 7-15 years. This is why it is so important that we protect our high credit ratings (AA+ rated GO debt/AA/AA- rated Water System debt/A+ rated Airport debt and A rated facilities rated debt), and preserve our ability to access the capital markets and not only borrow but borrow at incredibly low rates.

What's at stake for the issuer in this regard?

In the wake of the 2008 financial crisis, regulation regarding municipal disclosure increased significantly. Effective July 1, 2009, issuers are now required to submit all disclosure information to one central repository, the Municipal Securities Rulemaking Board's electronic access platform, EMMA. The SEC expanded material event notice requirements for municipal bonds including establishing a specific timeliness standard to file these notices—any material notice must be filed within 10 days of the event. The MSRB's electronic platform, EMMA, also presents the issuer with the opportunity to file a wealth of voluntary information. The more transparency the better...this increased transparency can increase the liquidity of your bonds making them trade at tighter spreads in the secondary market, which can significantly reduce your borrowing costs for original debt issuances. When the investor is provided with more information, she feels empowered to make a better decision....if not, she may opt to pass on investing in your bonds or price in some information deficit premium.

Amendments to Rule 15c-2-12 included the removal of exemption for variable rate debt and more expanded material event notice requirements. Issuers were required to comply with the new requirements by December 1, 2010. The Board appeared to recognize that continuing disclosure was needed regarding variable rate debt in the wake of the 2008 financial crisis where we became all too familiar with terms like "bank bonds." Consequently, substitution or replacement of credit facilities and draws on facilities are now considered material event notices. So while many may bemoan the increased disclosure requirements, we actually welcome these stepped up regulatory efforts to increase transparency and foster communication between us and investors.

It has also resulted in increased due diligence efforts by many of the participants in our bond issuance process. While this can lengthen the time it takes to bring a deal to market, the upside is that it increases the likelihood of a successful transaction. Given the increased regulatory requirements, my advice would be simply to plan for this by building additional time into your issuance process. To address the additional continuing disclosure requirements, our office has established internal compliance procedures requiring periodic review of our continuing disclosure submissions by multiple staff members.